IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF IDAHO

IN RE	)	
	)	**Case No. 98-01187**
PRO-AG, INC., and PRO-AG PARTNERSHIP,	)	
	)	
Debtor.	)	
_____	)	
	)	
BERNIE R. RAKOZY, Trustee,	)	
	)	**Adv. No. 00-6112**
Plaintiff,	)	
	)	**MEMORANDUM OF DECISION RE PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT AND PLAINTIFF'S MOTION TO STRIKE AFFIDAVITS**
vs.	)	
	)	
PARSONS PACKING, INC., an Idaho corporation, and ROBERT A. PARSONS,	)	
	)	
Defendants.	)	
_____	)	

Background

In this adversary proceeding, commenced on March 29, 2000, Chapter 7 Trustee Bernie R. Rakozy ("Plaintiff") seeks a determination that a contract concerning certain onion bins and processing equipment was a "disguised installment sales contract" rather than a "true" lease. Because the security interest created by the sales contract was, allegedly, never properly

perfected, Plaintiff contends he has the right to liquidate the bins and equipment as property of the bankruptcy estates free and clear of any claims of the Defendants Parsons Packing, Inc. or Robert Parsons. Before the Court for disposition is Plaintiff's Motion for Partial Summary Judgment (Docket No. 8), and Plaintiff's Motion to Strike and Exclude Affidavits (Docket No. 18). A hearing was held on August 2, 2000, after which time this matter was taken under advisement.

Facts.

The following facts appear undisputed.

On October 15, 1992, Debtors[1] entered into a written agreement with Defendants[2] entitled "Lease with Option to Purchase" wherein Debtors acquired the use of approximately 15,000 onion bins and other processing equipment. This contract was amended by the parties several times, culminating

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[1] In this business enterprise, Pro-Ag, Inc., a corporation, served as the operating entity, while Pro-Ag Partnership held title to the real and personal property assets of the business. For purposes of this decision, however, and for reasons explained below, both Pro-Ag entities are collectively referred to herein as "Debtors" unless otherwise noted.

[2] Plaintiff's Complaint names both Parsons Packing, Inc., and Robert A. Parsons as defendants, who will be collectively referred to herein as "Defendants" unless otherwise noted.

in an amendment entitled "Addendum to Lease Agreement" ("Agreement"), executed on September 12, 1994. The Agreement provided that Debtors would make monthly installments to Defendants for a term of months, at the end of which, Debtors would purchase the bins and equipment from Defendants. Addendum to Lease Agreement, pp. 4, 14, attached to Affidavit of Robert A. Faucher. In conjunction with the execution of the Agreement, Debtors also were required to execute a UCC-1 financing statement and bill of sale covering the bins and equipment. *Id.* at 17. It is undisputed that the UCC-1 was never filed with the Idaho Secretary of State. Defendants' attorney drafted the various documents concerning this transaction, and it appears that the attorney held the original documents after they were signed.

During the term of the Agreement, on April 14, 1998, Debtor Pro-Ag, Inc. filed a voluntary petition under Chapter 11 of the Bankruptcy Code. This case was converted to a Chapter 7 case on July 28, 1998. On January 28, 2000, Pro-Ag Partnership filed for bankruptcy protection under Chapter 7. Plaintiff is the Chapter 7 Trustee appointed to serve in both bankruptcy cases. At Plaintiff's request, this Court ordered that the cases be jointly administered on February 29, 2000 (Case No. 98-01187, Docket No. 213).[3]

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[3] In the meantime, on August 12, 1998, and with the approval of the parties, this Court approved a sale and/or lease of the onion bins and equipment to a

Plaintiff asserts that rather than a true lease, the Agreement between Debtors and Defendants should be regarded as a disguised installment sales contract. Because Defendants never perfected the security interest created by the Agreement by filing the UCC-1, Plaintiff argues the "collateral" (i.e., the onion bins and equipment) may be treated as unencumbered property of the bankruptcy estates pursuant to Section 541 of the Bankruptcy Code, and liquidated for the benefit of the unsecured creditors. Such is the essence of the relief requested via Plaintiff's Motion for Partial Summary Judgment. Plaintiff also requests that three affidavits filed by Defendants in opposition to the motion be stricken or excluded from the record. Defendant resists summary judgment, arguing genuine issues of material fact remain for trial. Defendants also object to the striking of the affidavits.

Applicable Law

Summary judgment is only appropriate if, after viewing the evidence in the light most favorable to the non-moving party, there are no

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third party in the main bankruptcy case. *See* Order Approving Stipulation for Sale Free and Clear of Liens (Case No. 98-01187, Docket No. 164). The proceeds from this transaction are being held in trust by Plaintiff pending the outcome of this adversary proceeding, subject to a prior perfected security interest in the proceeds held by creditor Northwest Farm Credit Services. *See* Order of May 22, 2000 (Case No. 98-01187, Docket No. 220).

genuine issues of material fact remaining and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56; Fed. R. Bankr. P. 7056; *Anguiano v. Allstate Insurance Company*, 209 F.3d 1167, 1169 (9th Cir. 2000); *Newman v. American Airlines, Inc.*, 176 F.3d 1128, 1130 (9th Cir. 1999). Additionally, if the non-moving party bears the ultimate burden of proof on an element at trial, that party must make a showing sufficient to establish the existence of that element in order to survive a motion for summary judgment. *Celotex Corp. v. Catrett*, 477 U.S. 317, 322-23 (1986); *Nissan Fire & Marine Ins. Co., Ltd. v. Fritz Companies, Inc.*, 210 F.3d 1099, 1102 (9th Cir. 2000). A court may grant partial summary judgment "specifying the facts that appear without substantial controversy, including the extent to which the amount of damages or other relief is not in controversy, and directing such further proceedings in the action as are just." Fed. R. Civ. P. 56(d); Fed. R. Bankr. P. 7056(d); *V-1 Oil Co. v. U.S.A.,* 899 F.Supp. 468, 469 (D. Idaho 1995).

Discussion

1. **True Lease v. Disguised Installment Sales Contract**

The parties acknowledge, and the Court concurs, that the Idaho Uniform Commercial Code controls the outcome of this action. *In re Bumgardner,* 183 B.R. 224, 225 (Bankr. D. Idaho 1995) (whether a transaction is a true lease or a disguised security agreement is determined by state law). If the Agreement between the parties was a lease, under Section 365 of the Bankruptcy Code, it has been deemed "rejected" by operation of law, and Defendants as lessors would be entitled to reclaim the leased property, or in this case, the proceeds from that property. *See* 11 U.S.C. § 365(d)(1) (trustee has 60 days after entry of order for relief to assume an executory lease of personal property or the lease is deemed rejected). If the Agreement is actually a sale, and if Defendants did not properly perfect any security interest granted by the Agreement, Defendants' interest in the bins and equipment (and in the sale proceeds thereof) is likely avoidable by Plaintiff as trustee. *See* 11 U.S.C. § 544(a)(1).

Idaho Code § 28-1-201(37) defines "security interest" for purposes of the Idaho UCC, and provides the following guidelines to determine whether an agreement should be treated as an installment sales contract or a true lease:

> Whether a transaction creates a lease or security interest is determined by the facts of each case; however, a transaction creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an

> obligation for the term of the lease not subject to termination by the lessee," and [at least one of four factors is present, including whether:]
> . . . .
>
> (b) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods; . . .

Idaho Code § 28-1-201(37). The effect of this statute is to create

> an exception to the basic direction that the determination is made on the facts of each case, as it provides that without looking at all the facts, a lease will be construed as a security interest if a debtor cannot terminate the lease, and if one of the four enumerated terms is present in the lease.

In re Zaleha, 159 B.R. 581, 583 (Bankr. D. Idaho 1993) (citation omitted).

Here, the Agreement grants Defendants the right to terminate the lease upon a breach of its terms by Debtors, *see* Addendum, p. 11, attached to Affidavit of Robert A. Faucher. However, Debtors are given no such rights under the contract. *Id.* at 12. The Agreement also provides, "[i]t is understood and agreed between the parties hereto that Lessor and Lessee have irrevocably committed to the sale and purchase of the property herein." *Id.* at 14.[4]

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[4] The Agreement also contains an integration clause, indicating "[t]his Lease sets forth the entire agreement between the parties. Any prior conversations or writings are merged herein and are extinguished." Addendum, p.16. It is neither necessary nor appropriate, then, for the Court to look beyond the terms of the Agreement to construe its terms. *Kimbrough v. Reed,* 943 P.2d 1232, 1235 (Idaho 1997); *Chambers v. Thomas,* 844 P.2d 698, 701 (Idaho 1992).

Defendants have conceded that by the terms of the Agreement, Debtors had no legal right to terminate the "lease," and that Debtors were irrevocably bound to become the owners of the onion bins and equipment. Additionally, it is undisputed Defendants did not file any UCC-1 financing statement to perfect the security interest granted them by operation of the Agreement. Idaho Code § 28-9-302. Given these two factors, the Court must conclude, as a matter of law, that the Agreement created a security interest rather than a true lease, Idaho Code § 28-1-201(37); *In re Zaleha*, 159 B.R. at 583, and that the security interest was unperfected. However, Defendants raise two issues which should be addressed in connection with the Court's decision.

2. Intent of the Parties

Defendants contend genuine issues of material fact exist regarding the intent of the parties concerning the nature of the Agreement. Defendants assert that, during the process of the negotiation and drafting of the Agreement, the parties operated under a mutual mistake concerning the effect of the contract. For support, Defendants offer the affidavit of Defendant Robert A. Parsons (Docket No. 14).

Ordinarily,

> [t]he parol evidence rule provides that once a contract has been reduced to writing, which the parties intend to be a final

> representation of the agreement, any prior or contemporaneous agreements or understandings which vary or contradict the terms of the written contract may not be introduced. The parol evidence rule allows the use of extrinsic evidence to show the intent of the parties only when the writing is ambiguous."

In re Race, 98.1 I.B.C.R. 22, 23 (Bankr. D. Idaho 1998) (citing *Hall v. Hall*, 777 P.2d 255, 256 (Idaho 1989); *Herrick v. Leuzinger*, 900 P.2d 201, 208 (Idaho Ct. App. 1995)).

However, "when mutual mistake is alleged, parol evidence is admissible to show that mutual mistakes were made." *Moore v. Mullen*, 855 P.2d 70, 72 (Idaho Ct. App. 1993). "A mutual mistake occurs when both parties, at the time of contracting, share a misconception regarding a basic assumption or vital fact upon which the bargain is based." *Hines v. Hines*, 934 P.2d 20, 26 (Idaho 1997).

The parol evidence that Defendants request the Court to consider in this action, however, does not establish the existence of any mutual mistake. In his affidavit, Mr. Parsons testifies that, among other things, all parties to the 1994 Agreement intended the contract to be in the nature of a lease, and that Defendants would remain the owner of the bins and equipment unless and until Debtors actually purchased the goods by paying the purchase price. Affidavit of Robert A. Parsons, ¶¶ 6-10. Even assuming, however, that he may testify

concerning Defendants' intentions in entering into the Agreement, Mr. Parsons is surely not competent to testify as to the intentions of Debtors' representatives concerning the nature of the contract. Mr. Parsons' affidavit does not evidence any sort of personal knowledge concerning Debtors' intentions, and affidavits not based upon personal knowledge cannot be employed to raise a genuine issue of material fact sufficient to withstand a motion for summary judgment. *Skillsky v. Lucky Stores, Inc.*, 893 F.2d 1088, 1091 (9th Cir. 1990); *Grzybowski v. Aquaslide 'n' Dive Corp. (In re Aquaslide 'n' Dive Corp.)*, 85 B.R. 545, 548 (9th Cir. B.A.P. 1987).

Plaintiffs ask the Court to strike this affidavit. While the Court is not inclined to strike Mr. Parsons' affidavit in its entirety, to the extent the affidavit is offered as proof of Debtors' intent to demonstrate an alleged mutual mistake, it will not be considered by the Court.

Defendants contend that, given the "true" intentions of the parties, they are entitled to reformation of the Agreement. Obviously, granting them such relief would prejudice the interests of the unsecured creditors, represented here by Plaintiff as Chapter 7 trustee. While a request to reform the contract may be appropriate to prevent an injustice as between the parties to a contract, *see, e.g. U.S. Bank National Assoc. v. Kuenzli,* 999 P.2d 877, 882 (Idaho 2000),

the rights of others are adversely impacted under these facts. Put another way, the "equities" presented here are different than in the classic situation where one party to a contract seeks reformation of its terms to give it true effect based upon the existence of an alleged mutual mistake as against the other party to the contract. As a matter of law, Plaintiff does not stand in the same shoes as Debtors, even if a mutual mistake can be established. Instead, Plaintiff is a representative of the interests of the bankruptcy estates and the unsecured creditors, *see* 11 U.S.C. § 541(a), and is clothed with the rights of a hypothetical third-party lien creditor in challenging the asserted secured interests of others, *see* 11 U.S.C. § 544(a)(1). The policies of the Code require the Court to reject a request for equitable relief, the results of which defeat the statutory mandate that creditors holding similar claims be treated in the same fashion. *See Begier v. I.R.S.,* 496 U.S. 53, 57 (1990).

Moreover, Defendants have shown the Court nothing in this record that justifies the intervention of equity, or otherwise renders the outcome of this transaction unconscionable or shocking. This was a substantial commercial transaction in which Defendants had the benefit of counsel. Defendants structured the contract in a manner to both allow them an easy departure from the deal if Debtors were to default, while at the same time ensuring Debtors were

obligated to buy the goods. Idaho law treats such a contract as a conditional sale, not a true lease, a consequence of which Defendants should have been aware. Equity should not intervene to the excuse Defendants' or their counsel's ignorance of the legal ramifications of such an approach, or to excuse their failure to record the UCC-1 that they required from Debtors.

Because the written Agreement of the parties here seems clear and unambiguous, and because Defendants have failed to raise a genuine issue of material fact regarding the existence of an alleged mutual mistake, *Celotex*, 477 U.S. at 322-23 (1986), parol evidence will not be allowed to vary the terms of the Agreement.

3. Identity of the Parties

Defendants also assert that a genuine issue of material fact exists as to which Pro-Ag entity was a party to the Agreement. Apparently, one copy of the Agreement contains a signature page signed by representatives of Pro-Ag, Inc., while the original document does not, and while the introductory paragraphs of the Agreement recite that the partnership, not the corporation, was the party to the Agreement. In support of this contention, Defendants offer the affidavits of attorneys Brad Masingill (Docket No. 15) and Joseph M. Meier (Docket No. 13). Mr. Masingill, Defendants' attorney who drafted the contract documents, testifies

in his affidavit that the correct party to the 1994 Agreement was Pro-Ag Partnership rather than the corporation. Mr. Meier is Defendants' attorney in this action and in the bankruptcy cases. His affidavit includes information regarding the various proofs of claim which have been filed in the two bankruptcy cases.

In the Court's opinion, although the identity of the parties to the contract may constitute an issue of fact, for purposes of this summary judgment motion, it is not material which of the Debtor entities, if not both, participated in the Agreement. "'Only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment. Factual disputes that are irrelevant or unnecessary will not be counted.'" *California v. Campbell,* 138 F. 3d 772, 782 (9th Cir. 1998) (quoting *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 247-48 (1986)).

The focus of this action is whether the Agreement, which purports to be a lease, was actually a disguised installment sales contract, for purposes of the bankruptcy cases. The legal effect given to the Agreement at this point is the same, no matter which Debtor executed it, and thus, any question regarding the identity of the signers does not raise a genuine issue of material fact.[5]

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[5] Additionally, it should be noted that on July 26, 1999, the Court approved a compromise in the bankruptcy cases allowing all assets and interests of Pro-Ag Partnership to be transferred to the bankruptcy estate of Pro-Ag, Inc., for purposes of administration. (Case No. 98-01187, Docket No. 204). This transaction

Therefore, while the Court will decline Plaintiff's request to strike the affidavits of Mr. Masingill and Mr. Meier in their entirety, matters raised therein which are not material to the issues at hand will not be considered by the Court in its disposition of Plaintiff's Motion for Partial Summary Judgment.

Conclusion

For the reasons stated above, the Court concludes that as a matter of law, the September 12, 1994, Agreement is a disguised installment sales contract rather than a true lease. The bins and equipment therefore constitute property of the Debtors' bankruptcy estates. Because it is undisputed that Defendants failed to perfect the security interest granted by the Agreement, Defendants' claims to the bins and equipment, and the proceeds thereof, are likely avoidable by Plaintiff as Chapter 7 trustee. Accordingly, Plaintiff's Motion for Partial Summary Judgment (Docket No. 8) will be granted. Plaintiff's Motion to Strike and Exclude Affidavits (Docket No. 18) will be denied. A separate order will be entered by the Court.

DATED This 5th day of September, 2000.

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further renders a determination as to which Debtor signed the September 12, 1994, Agreement insignificant to the resolution of Plaintiff's Motion for Partial Summary Judgment.

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JIM D. PAPPAS
CHIEF U.S. BANKRUPTCY JUDGE

CERTIFICATE OF MAILING

I, the undersigned, hereby certify that I mailed a true copy of the document to which this certificate is attached, to the following named person(s) at the following address(es), on the date shown below:

Office of the U.S. Trustee
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ADV. NO.: 00-6112

CAMERON S. BURKE, CLERK
U.S. BANKRUPTCY COURT

DATED: September 5th, 2000

By_____
Deputy Clerk